

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

MORPHEUS LIGHTS, INC.,
Debtor.

Case No. 96-54222-JRG
Chapter 11

VARIABLE-PARAMETER FIXTURE
DEVELOPMENT CORPORATION,

Adversary No. 98-5089

Plaintiff,

vs.

**ORDER GRANTING COMERICA'S MOTION
TO DISMISS CLAIMS FOR EQUITABLE
SUBORDINATION AND CONSPIRACY TO
BREACH FIDUCIARY DUTY AND
DENYING MOTION TO DISMISS CLAIM
FOR UNFAIR COMPETITION**

COMERICA BANK-CALIFORNIA, a
corporation, and PETER DALTON,
an individual,

Defendant.

I. INTRODUCTION

Before the court is Defendant Comerica-Bank California's Motion to Dismiss the Complaint filed by Plaintiff Variable-Parameter Fixture Development Corporation.¹ On March 6, 1998, Variable, a general unsecured creditor of the debtor in possession, Morpheus Lights, Inc., filed a

¹ The hearing was held concurrently with Peter Dalton's motion to dismiss. Both motions were taken under submission at that hearing and the court is issuing decisions on the motions concurrently as well.

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1 complaint for: (1) equitable subordination; (2) breach of fiduciary duty;
2 (3) conspiracy to breach fiduciary duty; and (4) unfair competition. The
3 complaint names two defendants, Comerica, a lender of the debtor, and
4 Peter Dalton, the President and CEO of the debtor. The essence of the
5 complaint is that Comerica and Dalton have engaged in a pattern of
6 improper post-petition conduct whereby Comerica and Dalton have taken
7 control of the debtor and the bankruptcy case for their own benefit. Such
8 conduct allegedly constitutes a breach of Dalton's fiduciary duties,
9 renders Comerica liable for enabling such a breach, constitutes unfair
10 competition, and justifies equitable subordination of Comerica's c

11 The complaint alleges three claims for relief against Comerica: Claim
12 I is for equitable subordination under 11 U.S.C. § 510(c); Claim III is
13 for conspiracy to breach fiduciary duty; and Claim IV is for unfair
14 competition. Comerica has brought this motion to dismiss all three
15 claims.

16 **II. EQUITABLE SUBORDINATION**

17 Claim I is for equitable subordination under 11 U.S.C. § 510(c).
18 Variable requests equitable subordination of Comerica's claims to all
19 general unsecured creditors due to Comerica's alleged misconduct.
20 Comerica contends that Claim I should be dismissed under Rule 12(b)(1) for
21 lack of jurisdiction over the subject matter because Variable lacks
22 standing to assert the claim.² The court agrees.

23
24 ² Comerica also argues that the claim for equitable subordination should be dismissed
25 because it fails to allege inequitable conduct on the part of Comerica, and it fails to allege
26 any injury to unsecured creditors or unfair advantage to Comerica. Because Variable has no
standing at this time, the court does not need to address the additional arguments made by
Comerica.

**A. A GENERAL UNSECURED CREDITOR DOES NOT HAVE STANDING TO BRING AN
EQUITABLE SUBORDINATION CLAIM**

Comerica contends that there is no clear authority in the Ninth Circuit in support of the proposition that an individual creditor has standing to assert a claim for equitable subordination. Comerica contends that there is no authority which would support a finding that Comerica lacks standing to sue for equitable subordination. The court agrees that there are very few cases in any circuit discussing the issue.³

³ There are a few cases which discuss a creditor's standing to bring an equitable subordination claim.

In 1981, a New York bankruptcy court held that the trustee is the proper party to bring an equitable subordination claim. The court stated that the trustee is the representative of the creditors and not the debtor. In re Lockwood, 14 B.R. 374 (Bankr. E.D.N.Y. 1981).

In 1983, an Oklahoma bankruptcy court held that the debtor does not have standing to pursue an equitable subordination claim. The court stated that the proper party is the creditor or the trustee acting as representative of the creditor. In re Weeks, 28 B.R. 958, 960 (Bankr. W.D.Okla. 1983).

In 1990 the Fifth Circuit addressed whether an individual creditor has standing to seek equitable subordination under § 510(c). In In re Vitreous Steel Products Co., 911 F.2d 1223 (5th Cir. 1990), the court refused to allow an unsecured creditor the right to pursue certain counts in an adversary complaint relating to the affirmative recovery of assets for the estate. Id. at 1230-31. The court did, however, allow the unsecured creditor standing to seek equitable subordination under § 510(c). Id. at 1231. Unfortunately, the decision lacks any discussion of the standards that should be applied in determining whether the granting of standing is appropriate. The court makes a distinction between equitable subordination and actions that would affirmatively recover assets. The court stated that:

However, [the unsecured creditor] does have standing to seek equitable subordination of the Bank's claim in bankruptcy under § 510(c). Equitable subordination is not a benefit to all unsecured creditors equally, at least where the creditor whose claim is objected to is at least partially unsecured; it is a detriment to the creditor whose debt is subordinated. Thus, when a party seeks equitable subordination, it is not acting in the interests of all the unsecured creditors. While the Trustee may find that it is in the best interests of the estate to seek equitable subordination, individual creditors have an interest in subordination separate and apart from the interests of the estate as a whole. The individual creditor should have an opportunity to pursue its separate interest.

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Whether an individual creditor can bring an equitable subordination claim against another creditor turns on whether the creditor-plaintiff is the holder of the claim. If the creditor-plaintiff holds the claim, then the creditor-plaintiff has standing to pursue its claim. If, for example, the estate holds the claim, then a representative of the estate, such as the trustee or debtor in possession, is the proper party to bring the claim. Such an analysis is necessary to promote the orderly and equitable administration of the bankruptcy estate by preventing individual creditors from pursuing separate actions to the detriment of other creditors and of the estate as a whole. See Solow v. Stone, 994 F.Supp 173 (S.D.N.Y. 1998).

The analysis begins with whether the claim constitutes property of the bankruptcy estate. A creditor-plaintiff only has standing if the claim is not property of the estate because property of the estate does not belong to any individual creditor. See Kalb Voorhis & Co. v. American Financial Corp., 8 F.3d 130, 132 (2nd Cir. 1993).

Whether a claim is property of the estate or of an individual creditor depends on whether the claim is general or particular. "If a claim is a general one, with no particularized injury arising from it, and

The court has held that equitable subordination should be viewed differently than an affirmative recovery because equitable subordination benefits all creditors except the creditor subordinated and an affirmative recovery benefits all creditors except the creditor being sued. It has been argued that the court has created a distinction without a true difference. See Craig H. Averch, *The Ability to Assert Claims on Behalf of the Debtor: Does A Creditor Have a Leg to Stand On?*, 96 Comm.L.J. 115, 126 (1991) (criticizing the court's reasoning in In re Vitreous Steel Products Co..) Without guiding standards to determine when it is appropriate to grant standing to an unsecured creditor, the court does not find this case determinative.

1 if that claim could be brought by any creditor of the debtor, the trustee
2 is the proper person to assert the claim, and the creditors are bound by
3 the outcome of the trustee's action." Id. quoting St. Paul Fire and
4 Marine Ins. Co., v. PepsiCo, Inc., 884 F.2d 688, 700-01 (2d Cir.1989)
5 (citations omitted). When no trustee has been appointed, as in this case,
6 a debtor in possession has all the rights and powers, and shall perform
7 all the functions and duties of a trustee. See 11 U.S.C. § 1107(a). For
8 purposes of deciding the standing issue, an unsecured creditors committee
9 asserting claims on behalf of Chapter 11 debtor also stands in a position
10 analogous to that of a trustee and, thus, could be treated as though it
11 were a trustee. See Matter of Mediators, Inc., 190 B.R. 515 (Bankr.
12 S.D.N.Y. 1995). In this case an Official Unsecured Creditor's Committee
13 (creditor's committee) has been formed. Hence, any generalized claims
14 should be brought by the debtor in possession or creditor's commit

15 If it could be shown that Variable has been particularly harmed by
16 inequitable conduct of Comerica, Variable would have standing to assert
17 a claim for equitable subordination. However, Variable has not alleged
18 any injury particular to it. Variable does allege that "Comerica and
19 Pacific Western Bank have exercised control over the Morpheus' settlement
20 of a pending patent infringement lawsuit by Variable-Parameter..." See
21 Complaint ¶ 14, p. 5. However, the injury that Variable alleges is a
22 general one. Variable alleges that "during the pendency of this case,
23 Comerica has worked with Dalton toward acquisition of Morpheus, and use
24 of its assets, for the sole or principal benefit of Comerica and Dalton,
25 to the detriment of Morpheus' unsecured creditors." See Complaint ¶ 16,

1 p. 5. Variable alleges that all unsecured creditors have been injured
2 alike and that any indebtedness of the debtor to Comerica should be
3 equitably subordinated to that owed all general unsecured creditors.
4 Because Variable has not alleged a particularized injury, Morpheus or the
5 creditor's committee are the proper parties to assert a claim for
6 equitable subordination.

7 However, the question remains: if the proper party to bring the claim
8 has not instituted a claim, or refuses to institute a claim, can a general
9 creditor then bring an equitable subordination claim?

10 **B. IF THE PROPER PARTY TO BRING AN EQUITABLE SUBORDINATION CLAIM**
11 **DOES NOT BRING THE CLAIM, AN UNSECURED CREDITOR DOES NOT HAVE**
12 **STANDING TO PURSUE THE CLAIM ABSENT COURT APPROVAL**

13 As a practical matter, bankruptcy law views the management of a
14 debtor as a neutral party who is the maximizer of value for all parties-
15 in-interest. See Craig H. Averch, The Ability to Assert Claims on Behalf
16 of the Debtor: Does A Creditor Have a Leg to Stand On?, 96 Comm.L.J. 115
17 (1991). However, in some cases, management of the debtor is not a neutral
18 party and has its own agenda. This is especially true when the debtor is
19 called upon to recover assets of the estate in the form of claims against
20 current management. Id. Management of the debtor may also be reluctant
21 to bring a lawsuit against management-friendly lenders or shareholders for
22 equitable subordination or other affirmative actions. Id.

23 In First Bank Billings v. Feterl Mfg. Co. (In re Parker Montana Co.),
24 47 Bankr. 419 (D.Mont 1985), the district court affirmed a bankruptcy
25 court judgment dismissing an equitable subordination claim asserted by a
26 creditor. The court held that if a general creditor applied to the

1 trustee to object to another creditor's claim, and the trustee refused to
2 object, and the court authorizes the creditor to proceed, a general
3 creditor may have standing to object. However, barring permission, the
4 creditor could not proceed. Thus, the creditor is required to seek court
5 permission to bring a claim on behalf of the estate.

6 The Ninth Circuit Bankruptcy Appellate Panel has considered the issue
7 of creditor standing in an avoidance action, which by statute should be
8 brought by the trustee or debtor in possession. The BAP held that
9 creditors generally have no remedy to institute an avoidance action except
10 through the trustee or debtor in possession. See In re Curry and
11 Sorenson, Inc., 57 B.R. 824, 828 (9th Cir. BAP 1986). If a creditor is
12 dissatisfied with the inaction of the trustee or debtor in possession, its
13 remedies include moving for replacement of the debtor in possession with
14 a chapter 11 trustee, for conversion of the case to one under chapter 7,
15 for dismissal of the chapter 11 case, for an order compelling the debtor
16 in possession to take action or conferring standing upon the creditor to
17 institute the action. Id. at 828. Thus, the BAP found that a creditor
18 may seek the court's permission to institute an action.

19 In addition, in In re LMJ, Inc., the court held that the proper
20 remedy of a creditor when confronted with a debtor in possession who
21 declines to perform fiduciary duties, such as to move to set aside an
22 alleged fraudulent transfer, is to petition for appointment of trustee.
23 In re LMJ, Inc., 159 B.R. 926, 928 (Bankr. D.Nev. 1993) citing In re
24 Baugh, 60 B.R. 102 (Bankr. E.D.Ark.1986). An alternative option might be
25 to seek permission from the trustee or bankruptcy court to commence such
26

1 an action. See In re Munoz, 111 B.R. 928 (Bankr. D.Col.1990). Hence, a
2 creditor does not have standing to intervene due to a trustee or debtor
3 in possession's inaction without court approval.

4 The court finds that requiring a creditor-plaintiff to seek the
5 court's permission before bringing a claim on behalf of the estate is
6 supported by sound policy reasons. The requirement promotes the orderly
7 and equitable administration of the bankruptcy estate. If individual
8 creditors were permitted to pursue separate actions to the detriment of
9 other creditors and of the estate, the administration of the bankruptcy
10 estate would be chaotic.

11 Thus, the court concludes that the debtor in possession or the
12 creditor's committee are the holders of the equitable subordination claim.
13 If Variable is dissatisfied with the parties' inaction, it can request an
14 order compelling the parties to take action or request court permission
15 to institute the claim. The court concludes that absent court permission,
16 Variable does not have standing to pursue the claim for equitable
17 subordination. The motion to dismiss is granted as to Claim I.

18 **III. CONSPIRACY TO BREACH FIDUCIARY DUTY**

19 Claim III is for conspiracy to breach fiduciary duty against Comerica
20 and Dalton. In the complaint, Variable alleges that Comerica and Dalton
21 have conspired to cause a breach of Dalton's fiduciary duty owed to
22 Variable and other unsecured creditors. Although Comerica has not
23 requested dismissal of this claim on the basis of lack of standing, the
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1 issue of standing must be addressed at the outset.⁴

2 As the court found above, a plaintiff only has standing if it is the
3 holder of the claim. If the claim is property of the estate, the estate
4 is the holder of the claim. Whether a claim is property of the estate or
5 of an individual creditor depends on whether the claim is general or
6 particular. Where it could be shown that Variable has been individually
7 harmed by Comerica's conspiracy to breach the fiduciary duty owed by
8 Dalton, Variable has standing to assert a claim. However, Variable has
9 not alleged any injury particular to it. Because Variable has not alleged
10 a particularized injury, Morpheus or the unsecured creditor's committee
11 are the proper parties to assert a claim for conspiracy to breach
12 fiduciary duty. Although Peter Dalton is the responsible person for
13 Morpheus, Variable is not without a remedy. Variable may seek court
14 permission to bring the claim. Thus, because Variable lacks standing, the
15 motion to dismiss Claim III is granted.

16 **IV. UNFAIR COMPETITION**

17 Claim IV is for unfair competition under California Business and
18 Professional Code § 17200. Variable contends that it and the general
19 public have been injured by Comerica's unfair business practices.
20 Variable has standing to bring an action on its own behalf or on behalf
21 of the general public. Committee on Children's Television, Inc. v.
22 General Foods Corp., 35 Cal.3d 197, 209 (1983). Comerica does not dispute

24 ⁴Comerica argues that the conspiracy to breach fiduciary duty claim should be dismissed
25 because it fails to state a claim upon which relief may be granted and it is barred by the
26 litigation privilege. Because Variable lacks standing at this time, the court does not need
to address the arguments made by Comerica.

1 the issue of standing. Comerica contends that Claim IV should be
2 dismissed because: (1) the claim is barred by the litigation privilege;
3 and (2) the complaint fails to state a claim upon which relief can be
4 granted under Rule 12(b)(6).

5 **A. LITIGATION PRIVILEGE**

6 The Litigation Privilege is codified in California Civil Code § 47
7 which in pertinent part provides that "a privileged publication or
8 broadcast is one made... in any... judicial proceeding..." The California
9 Supreme Court has held that:

10 [T]he privilege applies to any communication (1) made in
11 judicial or quasi-judicial proceedings; (2) by litigants or
12 other participants authorized by law; (3) to achieve the
objects of the litigation; and (4) that have some connection
or logical relation to the action [citations omitted.]

13 Silberg v. Anderson, 50 Cal.3d 205, 212 (1990). The purpose of the
14 privilege is to allow litigants "the utmost freedom of access to secure
15 and defend their rights." Id.

16 Comerica contends that the actions complained of in the complaint are
17 all barred from suit by the litigation privilege. Comerica states that
18 the following alleged acts of misconduct are based on Comerica's conduct
19 in the bankruptcy proceeding: (1) Comerica settled its motion to appoint
20 a chapter 11 trustee; (2) Comerica exercised substantial control over the
21 operations of Morpheus; (3) Comerica exercised control over Morpheus'
22 settlement of a pending patent infringement lawsuit; (4) Comerica agreed
23 to move Morpheus' operations to Redding; (5) Comerica controlled Morpheus.

24 Comerica has separated out those actions that Variable complains of
25 which do have a substantial connection to the bankruptcy proceedings.

1 However, the crux of the allegations against Comerica is that it has
2 exceeded its role as a mere lender to the debtor and has exercised control
3 through a pattern of wrongful acts and unfair practices which has injured
4 the debtor, creditors and estate. This type of conduct is separate and
5 distinct from conduct typically found within even the most litigious court
6 proceedings. The litigation privilege does not bar suits addressing such
7 injurious conduct.

8 **B. FAILURE TO STATE A CLAIM**

9 A Rule 12(b)(6) motion tests the legal sufficiency of the claims
10 stated in the complaint. De La Cruz v. Torney, 582 F.2d 45, 48 (9th Cir
11 1978). Under Rule 12(b)(6) any defendant may move to dismiss for failure
12 to state a claim upon which relief can be granted. The party moving for
13 dismissal has the burden of proving that no claim has been stated. To
14 prevail, the movant must show "beyond a doubt that the plaintiff can prove
15 no set of facts in support of his claim [that] would entitle him to
16 relief." Loral Terracom v. Valley National Bank, 49 F.3d 555, 558 (9th
17 Cir. 1995) (quoting Conley v. Gibson, 355 U.S. 41, 45-46 (1957)). This
18 language emphasizes the limited applicability of Rule 12(b)(6) as the
19 predicate for final dismissal of the action, a disposition courts
20 generally disfavor because it summarily terminates cases on their merits.
21 During this threshold review, "[t]he issue is not whether a plaintiff will
22 ultimately prevail but whether the claimant is entitled to offer evidence
23 to support the claims." Cervantes v. City of San Diego, 5 F.3d 1273,
24 1274-1275 (9th Cir. 1993) quoting Scheuer v. Rhodes, 416 U.S. 232, (1974).

1 For Rule 12(b)(6) purposes, the court must accept the plaintiff's
2 factual allegations as true, drawing all reasonable inferences in
3 plaintiff's favor. Anderson v. Clow, 82 F.3d 1480, 1485 (9th Cir. 1996);
4 Walleri v. Federal Home Loan Bank of Seattle, 83 F.3d 1575, 1580 (9th Cir.
5 1996) quoting Scheuer, 416 U.S. at 236.

6 The court should construe a plaintiff's allegations liberally,
7 because the rules require only general or "notice" pleading, rather than
8 detailed fact pleading. Leatherman v. Tarrant County Narcotics
9 Intelligence and Coordination Unit, 507 U.S. 163, 168 (1993). The test
10 is whether the facts pled would support any valid claim entitling
11 plaintiffs to relief under any theory, even if plaintiff erroneously
12 relied on a different legal theory. Bowers v. Hardwick, 478 U.S. 186, 201
13 (1986); Haddock v. Board of Dental Examiners, 777 F.2d 462, 464 (9th Cir.
14 1985). However, conclusory allegations or legal conclusions masquerading
15 as factual conclusions will not suffice to prevent a motion to dismiss.
16 See Epstein v. Washington Energy Co., 83 F.3d 1136, 1139 (9th Cir.

17 The Unfair Business Practices Act defines unfair competition as "any
18 unlawful, unfair or fraudulent business practice and unfair, deceptive,
19 untrue or misleading advertising." The Legislature intended that this
20 "sweeping language" include "anything that can properly be called a
21 business practice and that at the same time is forbidden by law."
22 Manufacturers Life Insurance Co. v. Superior Court, 10 Cal.4th 257, 268
23 (1995) citing Barquis v. Merchants Collection Assn., 101 Cal.Rptr. 745
24 (1972). The broad language enables courts to deal with the innumerable
25 "new schemes which the fertility of man's invention would contrive."

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1 Barquis, 101 Cal.Rptr. at 112.

2 The common law rule for unfair competition is grounded in injury to
3 competitors. Nationwide Mutual v. Dynasty Solar, 753 F.Supp 853 (1990).
4 However, under the Business and Professional Code, an unfair competition
5 claim is aimed to protect the general public as well as competitors. To
6 state a claim under the Act, one need not plead and prove the elements of
7 a tort. Instead, one need only show that members of the public are likely
8 to be deceived. Manufacturers, 10 Cal.4th at 257.

9 An unfair business practice occurs when the practice "offends an
10 established public policy or when the practice is immoral, unethical,
11 oppressive, unscrupulous or substantially injurious to consumers."
12 Podolsky v. First Healthcare Corp., 50 Cal.App.4th 632, 647. To test
13 whether a business practice is unfair involves an examination of that
14 practices's impact on its alleged victim, balanced against the reasons,
15 justifications and motives of the alleged wrongdoer. Id. In brief, the
16 court must weigh the utility of the defendant's conduct against the
17 gravity of the harm alleged to the victim. Id.

18 Thus, the issue before the court on this motion to dismiss is whether
19 Comerica has shown beyond a doubt that Variable can prove no set of facts
20 in support of a claim for unfair competition which would entitle Variable
21 to relief.

22 Variable alleges in the complaint that Comerica has engaged in unfair
23 business practices by: "(a) imposing confirmation of a plan of
24 reorganization as an event of default under the stock pledge; (b)
25 otherwise controlling Morpheus; (c) obtaining an equity interest in Vari-

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1 Lite and (d) committing other wrongful acts and conduct as aforesaid [in
2 the complaint.] See Complaint ¶ 31, p.9-10. Other wrongful acts that
3 Variable has alleged in the complaint include discouraging other investors
4 from purchasing the debtor's assets by refusing to make information
5 available about the debtor to prospective investors on reasonable terms.

6 The court finds that Comerica has not met its burden to show beyond
7 a doubt that Variable can prove no set of facts in support of a claim for
8 unfair competition which would entitle Variable to relief. Variable has
9 alleged facts sufficient to survive a motion to dismiss and is entitled
10 to offer evidence to support its claim of unfair competition. The motion
11 to dismiss Claim IV is denied.

12 **V. CONCLUSION**

13 Thus, based on the foregoing, the court grants Comerica's motion to
14 dismiss Claim I for equitable subordination and Claim III for conspiracy
15 to breach fiduciary duty based on Variable's lack of standing at this
16 point. Variable may bring these claims again if it obtains court
17 approval. The court denies Comerica's motion to dismiss Claim IV for
18 unfair competition.

19 DATED: October 21, 1998
20

21 /s/

22 JAMES R. GRUBE

23 UNITED STATES BANKRUPTCY JUDGE

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1 Adversary No. 98-5089

2
3 UNITED STATES BANKRUPTCY COURT
4
5 FOR THE NORTHERN DISTRICT OF CALIFORNIA
6
7 CERTIFICATE OF SERVICE

8 I, the undersigned, a regularly appointed and qualified Judicial
9 Assistant in the office of the Bankruptcy Judges of the United States
10 Bankruptcy Court for the Northern District of California, San Jose,
11 California hereby certify:

12 That I, in the performance of my duties as such Judicial Assistant,
13 served a copy of the Court's: **ORDER GRANTING COMERICA'S MOTION TO DISMISS**
14 **CLAIMS FOR EQUITABLE SUBORDINATION AND CONSPIRACY TO BREACH FIDUCIARY DUTY**
15 **AND DENYING MOTION TO DISMISS CLAIM FOR UNFAIR COMPETITION** by placing it
16 in the United States Mail, First Class, postage prepaid, at San Jose,
17 California on the date shown below, in a sealed envelope addressed as
18 listed below:

19 Office of the U.S. Trustee
20 U.S. Courthouse/Federal Bldg.
21 280 S. First St., Rm. 268
22 San Jose, CA 95113

23 Patrick Costello, Esq.
24 Craig M. Prim, Esq.
25 MURRAY & MURRAY
26 3030 Hansen Way, Suite 200
27 Palo Alto, CA 94304-1009

28 Peter M. Rehon, Esq.
MAHL REHON WALWORTH & ROBERTS
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Thomas C. Holman, Esq.
HOLMAN & O'GRADY
44 Montgomery Street, Suite 3450
San Francisco, CA 94104-4807

I declare under penalty of perjury under the laws of the United
States of America that the foregoing is true and correct. Executed on
_____ at San Jose, California.

LISA OLSEN

UNITED STATES BANKRUPTCY COURT

For The Northern District Of California

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